Committee on Resources

Witness Testimony

Statement of
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United States Department of Energy
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Subcommittee on Water and Power Resources
Committee on Resources
United States House of Representatives
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Mr. Chairman, thank you for inviting the Department of Energy (DOE) to testify before the Subcommittee today on the cost recovery and financing practices of the power marketing administrations (PMAs), which are separate and distinct agencies within DOE. My remarks focus on the practices of the Southeastern, Southwestern, and Western Area Power Administrations because these three PMAs are the subject of the recent U.S. General Accounting Office (GAO) report on this topic. I am accompanied by the Administrators of Southeastern and Southwestern power administrations, who are available to respond to specific questions you may have regarding their agencies. I will begin by providing the Subcommittee some background on these agencies.

BACKGROUND

The primary mission of these three PMAs is to market hydropower generated at Federal multipurpose (flood control, navigation, irrigation, power, recreation, etc.) water projects in their regions. By law, the PMAs are to market power that is "surplus" to the projects' own power needs (e.g. for water pumping) "in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles," and in addition, "Rate schedules shall be drawn having regard to the recovery (upon the basis of the application of such rate schedules to the capacity of the electric facilities of the projects) of the cost of producing and transmitting such electric energy, including the amortization of the capital investment allocated to power over a reasonable period of years" (Flood Control Act of 1944). The PMAs primarily market such power at wholesale rates to municipalities, rural electric cooperatives, tribal governments, and other non-profit utilities who blend this power with other power resources and resell it, at cost, to millions of end-use consumers. In addition, the Southwestern and Western Area Power Administrations sell power to certain Federal and state agencies directly as end users. Unlike the Bonneville Power Administration and other utilities, these three PMAs do not have a responsibility to meet electric load growth or construct generation units.

The Southwestern and Western Area Power Administrations own and operate high-voltage power transmission lines, and also make use of other utilities' transmission systems, in order to deliver power from Federal dams to their customers' power grids. The Southeastern Power Administration owns no transmission facilities and depends entirely on other utilities' power transmission systems for power delivery. Power generation is the responsibility of the Federal agencies that manage the multipurpose water projects, primarily the U.S. Army Corps of Engineers and the Interior Department's Bureau of Reclamation.

Annual operating expenses and capital investments of the PMAs and the generating agencies are generally funded through annual appropriations and power portions of these expenses are reimbursed through revenues collected from power customers. In addition, the Western Area Power Administration markets power from three projects that are permanently financed through revolving funds in the U.S. Treasury. In addition, there have been occasions when PMA customers advanced funds for capital investments in Federal power facilities in return for credits on their power bills or other financial considerations.

The PMAs set their power rates by water project and in accordance with authorizing statutes and DOE regulation. As provided by law, rates are set to recover power-related operations and maintenance costs of the PMA and the generating agency in the year they are incurred, and to repay, with interest, power-related capital investments of the PMA and generating agency within a defined repayment period. Power-related costs include a share of the project's multipurpose costs, in addition to costs directly attributable to power features. The Western Area Power Administration is also responsible for collecting sufficient revenue to repay, without interest, the capital investment in certain Federal irrigation projects that are beyond the irrigators' ability to repay. Revenues from the sale of power are deposited into various U.S. Treasury accounts, pursuant to applicable legislation. Attached to this testimony is a table that presents statistical data on these three PMAs.

GENERAL COMMENTS

I have some general comments for the Subcommittee's consideration as it addresses PMA cost recovery and financing practices.

The PMAs receive independent auditors' reports annually on their financial statements from qualified auditing and accounting firms. The audits are conducted in accordance with generally accepted auditing standards, audit standards issued by the Comptroller General (GAO), and audit requirements established by the Office of Management and Budget. For FY 1994 and 1995, all three PMAs received "unqualified" opinions from their independent auditors, meaning the auditors found that the financial statements fairly reflected the financial condition of the agency. The auditors also found that each PMA's combined financial statements were "in conformity with generally accepted accounting principles" (GAAP). Accounts are maintained in accordance with GAAP and the Federal Energy Regulatory Commission's uniform system of accounts for electric utilities. In addition, the combined power system financial statements are generally presented in accordance with the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 71, "Accounting for the Effect of Certain Types of Regulation".

I believe that the PMAs' current repayment practices follow current law or expressed Congressional direction. Opinions may differ as to whether these practices are good public policy. However, if this Congress believes that certain practices should be changed, legislation will need to be enacted in most cases.

Also, I question the usefulness of comparing the PMAs against other, nonfederal utilities for the purposes of determining why PMA power costs are lower. The PMAs have unique characteristics that make certain comparisons against other utilities of limited value. Specifically, these three PMAs do not have responsibility to meet load growth in their regions nor do they have authority to build or acquire new firm power resources -- primary responsibilities of "traditional" utilities. The acquisition of new firm power resources to satisfy load growth, or to increase market share, has been a significant component of high power costs for many utilities. The three PMAs are able to avoid such expenses.

These PMAs have a different mission -- legislated by Congress. They were established to market "surplus" hydropower from Federal water projects. This major difference makes it inappropriate to compare the costs of PMA hydropower against the coal- and nuclear-based power generated by other utilities. To the extent the PMA resource base is comparable to any other, it is most similar to hydroelectricity produced at nonfederal dams built during the 1940s - 1960s, when construction costs were low.

Finally, when evaluating the adequacy of the cost recovery of generation investments associated with the PMAs, it is important to acknowledge that the PMAs do not decide which Federal power generating investments to make -- these decisions are the responsibility of Congress, and the Army Corps of Engineers or Bureau of Reclamation. The PMAs are only responsible for marketing whatever "surplus" power is produced once the projects are constructed.

ADMINISTRATION POSITION ON COST RECOVERY

It is the policy of the Administration for the PMAs to fully recover all power-related costs associated with water projects from which they market power, unless special circumstances exist for having certain costs borne by others. Just as with any utility, it is only fair that the beneficiaries of Federal power repay the government for the costs of providing this service.

The GAO's draft report on PMA cost recovery identified several examples of costs that the GAO staff believed are not being fully recovered: -- post-retirement pension and health benefits; -- construction expenses for certain nonoperating facilities; -- Pick-Sloan Missouri Basin Program investment allocated for repayment to irrigation features that will likely never be built; -- certain environmental costs mandated by law to be nonreimbursable; and -- Western Area Power Administration's deferred operating payments. -- The cost of Treasury borrowing that is not fully reflected in the interest paid by power users on the Federal investment.

I would like to comment on certain of these examples.

With regard to the underrecovery of retirement and post-retirement health benefits for power-related employees of the PMAs and generating agencies who are under the Civil Service Retirement System (CSRS), the Administration will work with this Subcommittee and other jurisdictional committees to address this issue.

As far as underrecovery of project construction costs addressed in the GAO draft report is concerned, the

Richard B. Russell and Harry S. Truman Projects may eventually go into full operation and all power-related costs will be fully recovered through power rates. Therefore, we believe it is premature to conclude that the costs of the currently nonoperable generators will remain a taxpayer expense. If, in the future, this turns out not to be the case, the Administration will work with the Congress, the affected power users, and other interested parties to develop an acceptable cost recovery arrangement. Western's Mead-Phoenix Transmission Line is already included in a power repayment study for cost recovery, and the Deputy Secretary has asked Western's Administrator to submit new interim rates as soon as possible if a significant deviation from planned revenues is observed.

The Pick-Sloan's suballocation of costs to irrigation projects that will likely never be built results from the cost allocation adopted by the Bureau of Reclamation. I believe GAO's May 1996 testimony on this subject (GAO/T-RCED-96-142, FEDERAL POWER: Recovery of Federal Investment in Hydropower Facilities in the Pick-Sloan Program) accurately summarized this issue. As the May GAO testimony noted, "Recognizing that the program incorporates agreements reached decades ago, any changes between the program's power and irrigation purposes may also necessitate reviewing other aspects of the agreements..." Furthermore, Congress has by law specifically barred the Bureau of Reclamation from administratively resolving this cost-allocation issue (DOE Organization Act of 1977).

The power-related environmental mitigation costs at two Western projects are nonreimbursable by power customers, as Congress specifically directed by statute (Energy and Water Development Appropriations Act of 1991, Reclamation Projects Authorization and Adjustment Act of 1992).

As the draft GAO report noted, certain Western projects incurred "deficits" in past years, due primarily to drought conditions that reduced hydroelectric generation and the fact that Western does not build up a contingency reserve to allow repayment to continue in poor water years. With the return of better water conditions, the deficits are being paid off with interest at Treasury's borrowing rate. During FY 1995, Western paid off $54 million (over 21%) of its $250 million in deferred liabilities outstanding at the beginning of the year. Western's current repayment studies project that by the end of FY 1998, the "deficit" total for Western should drop to $17 million. Therefore, no administrative or legislative action appears warranted.

Finally, in the case of the interest rates paid on Federal investments, some investments are repaid at interest rates that are substantially below the Treasury's cost of money at the time the investments were made. However, administrative policy changes to implement full cost recovery prospectively were made in 1970 and 1983. All new investment going into service now is assigned an interest rate that is based on Treasury's cost of long-term borrowing, unless Congress specifically directed otherwise. I would note also that the PMAs are not able to refinance investments made at interest rates that are above the current Treasury borrowing rate. The Administration is willing to work with the Subcommittee to address this issue.

Mr. Chairman, this concludes my remarks. If you or members of the Subcommittee have any questions, I would be pleased to answer them.

Power Marketing Administration Statistics

	Southeastern	Southwestern	Western Area
Annual Energy Sales in FY 1995	6,829 GWH[1]	7,716 GWH	34,031 GWH
Number of Powerplants Whose Output is Marketed (as of September 30, 1995)	23	24	56
Installed Capacity of Powerplants (as of September 30, 1995)	3,092 MW[2]	2,158 MW	10,581 MW
Circuit-miles of Transmission Line (as of September 30, 1995)	-0-	1,380	16,760
Total Operating Revenues in FY 1995	$159 million	$114 million	$713 million
Federal Investment Repaid in FY 1995	$33 million	$37 million	$40 million
Cumulative In-Service Investment that the PMAs are to Repay (as of September 30, 1995)	$1.5 billion	$1.0 billion	$6.3 billion[3]
Cumulative In-Service Investment that the PMAs Have Repaid (as of September 30, 1995)	$ 0.5 billion (34%)	$0.4 billion (36%)	$2.3 billion (36%)
Unpaid Balance of In-Service Investment[4]	$1.0 billion	$0.6 billion	$4.0 billion

(as of September 30, 1995)			
Cumulative Interest Paid to U.S. Treasury (as of September 30, 1995)	$0.9 billion	$0.6 billion	$2.0 billion

1 "GWH" stands for gigawatt hour, which is 1 billion watt-hours of electric energy.

2 "MW" stands for megawatt, which is 1 million watts of electrical capacity.

3 Includes $1.5 billion of Federal irrigation investment assigned to be repaid through power rates and $0.2 billion of non-Federal power investment.

4 Does not include $0.9 billion in construction work in progress as of September 30, 1995.

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